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SIPDIS

SENSITIVE

TREASURY FOR OAISA/JEWELL

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SUBJECT: Visit of Treasury Under Secretary for
International Affairs John B. Taylor

REF: Cape Town 536 (NOTAL)

SENSITIVE BUT UNCLASSIFIED; PROTECT ACCORDINGLY.

1. (SBU) Summary. Treasury U/S Taylor and DAS Fratto sought support from South African Finance Minister Manuel to a U.S. proposal to move from loans to grants for HIPC countries in the multilateral development banks. The Minister agreed that the HIPC program had lowered debt levels for participating countries but raised numerous questions about the proposal, including possible institutional affects and the long-term sustainability of donor flows to IDA and the AfDF. U/S Taylor told Manuel that the U.S. could not support the IFF and that global taxes for development were politically unacceptable. In a separate meeting, U/S Taylor and Reserve Bank Governor Mboweni discussed an IMF staff proposal to provide technical assistance to HIPC countries without requiring that a Fund program be in place.

2. (U) In Cape Town, U/S Taylor and DAS Fratto met with South African apparel and wine exporters benefiting from AGOA, and in Johannesburg, the Treasury officials visited a former township to see a range of low-income housing initiatives, including those benefiting from the USG/s African Mortgage Markets Initiative. Public diplomacy aspects of U/S Taylor's visit are reported in refetel. End Summary.

U.S. Proposal for IDA Grants

3. (SBU) In a September 8 Cape Town dinner meeting, Treasury Under Secretary for International Affairs John Taylor and DAS Tony Fratto discussed with Finance Minister Trevor Manuel and senior National Treasury officials a U.S. proposal to move from loans to grants for HIPC countries in the multilateral development banks (MDBs). U/S Taylor explained that the HIPC initiative had not succeeded in reducing the debt burden. HIPC countries found themselves in an absurd situation. They must borrow to repay debt. U/S Taylor said the donor community needed to find a way to stand down on debt while keeping resources flowing for developing countries. If donors did not find a way to stop the build up of debt, MDB resource flows would be wasted.

4. (SBU) Finance Minister Manuel said he agreed with the diagnosis, but he was not sure of the treatment. He was worried about the unintended consequences of the idea. He said the proposal to shift to grants could imply fundamental change in the World Bank as an institution. For the Minister, the AfDB/F was the key question. Changing the funding structure might destroy the institution. AfDB/F issue needs a separate look in his view. The Minister also expressed concern about the long-term sustainability of donor flows. He stated that the IDA pool of funds is currently not large enough to meet Millennium Development Goals. He asked what is the security of income to IDA? Will the U.S. Congress continue to support resources for IDA?

5. (SBU) U/S Taylor explained that the U.S. idea did not represent institutional change. IBRD loans would not be affected. The focus was strictly HIPC. Taylor agreed that sustaining flows was the key question and explained that the U.S. proposal would not reduce resources. In fact, IDA and other soft loan institutions, such as the AfDF, would actually get more funds. Taylor pointed out that IDA would always depend on donor funding. It will never be self-sustaining. He added that there was also a moral question of using reflows from countries like Ethiopia to pay for development in Niger. U/S Taylor said he had a higher degree of confidence in donor countries funding IDA than developing countries repaying IDA loans. In fact, IDA 14 contributions would be higher. U/S Taylor said he was optimistic

that the U.S. Congress would support grant funding,

16. (SBU) Ambassador Frazer added that HIPC simply was not working. We needed to change our approach to get HIPC countries to a sustainable level of development. The Ambassador said the international community had a window of opportunity to move ahead; we should not let the perfect be the enemy of the good. She emphasized that there is no political gain for U.S. in its proposal.

17. (SBU) Manuel noted that there are two other proposals on the table that would increase ODA to developing countries: the International Financing Facility (IFF) and some form of a global tax. While acknowledging that the U.S. had problems with the IFF, the minister said the international community needed to understand and explore the issues with the IFF and global taxation proposals. He noted that the U.S. proposal to move to grants in the MDB's and the other initiatives should not be seen as mutually exclusive.

18. (SBU) U/S Taylor replied that the IFF was fine if the Europeans wanted to pursue it, but the U.S. simply could not do it based on our own laws. The international tax was a non-starter: it would not fly domestically in the U.S.

19. (SBU) U/S Taylor said he believed the U.S. idea would be popular with African countries, as they would benefit most. He said the U.S. would like South African and international support and asked for Manuel's advice on how to approach others to discuss the proposal. The Minister suggested that the U.S. would need to address the systemic issues for the IBRD and regional institutions; answer questions of resource adequacy and flexibility; include ideas on the re-financing of existing loans; and think through the long term effects to create buy-in. Manuel also opined that the proposal was too easy for donor countries. The real need was for more multilateral funds.

FTA Negotiations -----

110. (SBU) U/S Taylor also discussed briefly with Minister Manuel, a former trade minister, the U.S.-SACU FTA negotiations. He noted that an FTA was the logical next step to build on the success of AGOA. He hoped the U.S. and SACU would move expeditiously to conclude the agreement by the end of the year. Manuel noted that he was "a bit of a purist" on trade issues, favoring an emphasis on multilateral negotiations. The Under Secretary commented that the U.S. was determined to move ahead on all trade fronts: multilateral, regional and bilateral.

AGOA Helps the Apparel Industry -----

111. (U) Following a September 9 breakfast briefing with South African journalists (reftel), U/S Taylor and DAS Fratto visited the House of Monatic, a clothing manufacturer producing for the South African and international market. Among those participating in the boardroom session were Fred Robertson, chief executive officer for Brimstone Investment Holdings, a Black Economic Empowerment company that owns House of Monatic; Brian Buckingham, manager for Monatic; and Jack Kipling, executive officer of the Clothing Export Council. House of Monatic employs over 1,000 workers and produces on the export side for Nordstrom, J.C. Penny, Dillards, and others in the U.S.

112. (U) Jack Kipling reported that AGOA was responsible for the creation of 12,000 new jobs in South Africa. He argued that it has been largely South African factors that have inhibited greater growth, including the high rand and the inability of local textile producers to provide sufficient fabric in a timely manner. Wage differentials are also hurting South African competitiveness with an average of about USD 2.05 paid per hour in Cape Town, placing it on par with Turkey. The South Africans, Kipling reported, were feeling especially keen competition from Madagascar and Mozambique, where labor cost per hour were well below 75 US cents per hour. Other factors cited by participants as responsible for dampening growth were the absence of direct U.S. foreign investment in clothing and a lack of interest in South African production on the part of U.S. textile suppliers. Robertson noted the importance of the clothing industry in job creation. He reported

on Brimstone's recent acquisition of a jean production plant, formerly owned by a Chinese company in Atlantis, a depressed community north of Cape Town, as a means of creating new jobs.

113. (U) On the negotiations for the FTA with SACU, Jack Kipling laid out the industry's position saying it fully supports an FTA, seeks to build a vibrant, sustainable clothing industry with as many as 500,000 jobs, and wants a regime that will allow greater South African access to third country fibers, even if it was only for a specified transition period of perhaps 15 years. Without substantial growth, Kipling feared the South African clothing industry would wither. A tour of House of Monatic operations followed the boardroom session.

Wine Exports, Too -----

114. (U) In conjunction with the Wines of South Africa, (South Africa's wine industry export council), Charles Back, owner of Fairview Estates in Paarl, hosted a small lunch for the U/S Taylor and DAS Fratto. Owner of a third generation-farm, Back has employed clever marketing strategies and catchy titles to attract attention in the U.S. and Europe. His Goats do Roam blend of red wine have made considerable headway in the U.S., reportedly selling over 1.2 million bottles in 2003. Back attributed his success to his ability to establish good and often personal working relations with American importers. Overall, individual makers like Back and marketing strategists at WOSA aim at cutting into the share of the market they believe overly dominated by Australia with good products at the lower end of the price spectrum.

Economy Finally Creating Jobs -----

115. (SBU) At the Governor's request, U/S Taylor and DAS Fratto met over breakfast September 10 in Pretoria with South African Reserve Bank Governor Tito Mboweni. Gov. Mboweni noted that, although the numbers were small, the South African economy was finally beginning to create jobs, particularly in the mining, manufacturing and construction sectors. He expressed concern about the continued growth of the services sector as a percentage of GDP. This sector would not absorb many of South Africa's poorly skilled unemployed. The Governor concurred with U/S Taylor's comment on the value of AGOA to Africa; however, he suggested that the U.S. try to do more to reduce non-tariff barriers. Econ M/C pointed out that the U.S. was already helping in this area, for example through USDA's APHIS, which worked closely with SA exporters. Mboweni felt that South Africa would see the benefits of more open trade over the coming 4-5 years with improved productivity.

Assisting African Central Banks -----

116. (SBU) U/S Taylor raised with Governor Mboweni a recent IMF staff proposal to provide technical assistance to HIPC countries without requiring that a Fund program be in place. U/S Taylor pointed out the program would be strictly voluntary. He noted that initial reaction from HIPC countries was positive and that some emerging market economies were also interested.

117. (SBU) Mboweni noted that many African countries want this type of assistance but are reluctant to call on the IMF due to its reputation: they prefer bilateral programs. He stated that South Africa had central bank technical assistance programs with all 13 other SADC members, plus Rwanda, Gambia and other African countries. He said that fortunately he had recently retired Reserve Bank staff that could provide the assistance but that it was "costing me money." He noted that he recently told Egyptian officials that the first thing to do was give the central bank independence. He noted that this was a hard message for many African governments to accept.

Housing Finance -----

118. (U) Prior to departure, U/S Taylor and DAS Fratto toured Alexandra, a former township adjoining Johannesburg's Sandton suburb. U/S Taylor saw a range of low-income urban housing, from squatter camps to government-provided single rooms houses to modest single-family homes typical of houses that

will be insured through USAID-guaranteed mortgage insurance programs, in conjunction with South Africa's Home Loan Guarantee Company. U/S Taylor also received a briefing on innovative OPIC-supported program that will support HIV/AIDs treatment for those who purchase the insurance product, enabling them to continue working and earning an income, maximizing their ability to provide support to their families. U/S Taylor noted the benefits of both programs, part of the USG's African Mortgage Markets Initiative.

19. (U) DAS Fratto cleared this message. Frazer